Summary of Business Rules for Accounting for and Reporting of Military Equipment

Full Cost

Objective

- Prescribe the costs that must be included in arriving at the full cost of an end item in accordance with the requirements of Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment.*

Baseline Valuation Methodology

- Obtain the acquisition cost of programs to date and planned number of end items using the following:
    - For programs in which production of end items has been completed, obtain actual acquisition costs and actual end items delivered from the accounting systems and accountability systems, respectively. If accounting data are no longer available or if retrieval is not practical, other sources such as budget information may be used.
    - For programs in the production phase for which there is considerable production and cost experience and for which there is evidence of program cost stability, obtain estimated acquisition cost data and planned number of end items from the Selected Acquisition Report; Exhibit P-40, Budget Item Justification Sheet; or similar sources.
    - For programs in early stages of production for which there are limited data about cost stability, obtain acquisition costs and the number of end items to be produced directly from the current acquisition contract or comparable data sources.
- Calculate the acquisition cost of each end item placed in service by (1) dividing actual acquisition costs by end items delivered, (2) dividing estimated acquisition costs by the planned number of end items to be produced, or (3) dividing contract costs by the number of end items to be delivered under the contract.
- Determine number of end items placed in service by date, and number of end items disposed of by date.
- Calculate depreciation through date of disposal or reporting date.
- Calculate the net book value of the end items acquired.
- Calculate the net book value of disposals/losses.

- Calculate the baseline net book value by subtracting the net book value of disposals/losses from the net book value of the end items acquired.

Mid-Term Valuation Methodology

- Capitalize all costs incurred to acquire and bring military equipment to a form and location suitable for its intended use. Examples of such costs include:
  - Amounts paid to vendors.
  - Government-furnished property installed in an end item, (e.g., an engine installed in an aircraft).
  - An appropriate share of the cost of the Government-furnished materials, (e.g., titanium used in the production of end items).
  - Direct cost of maintaining the Program Management Office.
- Capitalize separately special tooling and test equipment used in both production and post-production activities.

Military Equipment Valuation Project

Position Paper: Full Cost

Description of Issue

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting*, requires the measurement of the "full cost" of outputs so that operational costs and total unit costs of outputs can be determined. SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, provides guidance on what should be included in measuring the "full cost" of property, plant, and equipment (PP&E). SFFAS No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, amended SFFAS 6 to include PP&E previously defined as National Defense Property, Plant, and Equipment in the definition of General Property, Plant, and Equipment.

The Department of Defense (DoD) issued policies for implementing the foregoing SFFASs as they apply to PP&E covered by SFFAS No. 6 prior to issuance of SFFAS 23. DoD has not provided policy guidance on applying the full cost principle to military equipment. This position paper provides that guidance.

Proposed Policy

In accounting and reporting the "full cost" of PP&E[1], DoD should include all material costs incurred to acquire and bring the PP&E to a form and location suitable for its intended use.

Examples of such costs include:

- Amounts paid to vendors
- Government-furnished property installed in an end item
- An appropriate share of the cost of the Government-furnished materials used in the production of end items
- Direct cost of maintaining the Program Management Office

[1] This guidance applies only to property, plant, and equipment, exclusive of real estate, which includes land and buildings.

These full cost principles apply to all end items, such as items acquired on a fixed price basis, including fixed price commercial off-the shelf items.

The cost of PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for capital leases at inception. This is the present value of the lease payments calculated as specified in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, unless the present value exceeds the fair value of the asset.

Other direct costs include Government-furnished property installed in an end item (e.g., an engine installed in an aircraft) and Government-furnished materials (e.g., titanium) used in the production of end items.

Labor and other direct costs are comprised primarily of costs incurred by the contractor in the production process. However, labor and other direct costs should also include the direct costs of the Program Management Office (PMO), where material, e.g., greater than one percent of estimated total acquisition cost of the program. Direct PMO costs include personnel and travel costs, but associated costs such as occupancy costs and depreciation should not be included.

Indirect costs are costs incurred in the production of <u>two or more types</u> of end items. Indirect costs should be allocated to end items where material.

Special tooling and test equipment often remain in service long after completion of end item production and are used for follow-on maintenance and support efforts. Because special tooling and test equipment provide benefits after production, they should be capitalized separately.

Authoritative Guidance

<u>Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting*</u>

Paragraph 89. Full Costing – Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

Paragraph 90. Direct costs include costs that can be specifically identified with an output. Examples include:

- Salaries and benefits for employees who work directly on the output.
- Materials and supplies used in the work.
- Various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output.
- Cost of goods and services received from other segments or entities that are used to produce the output.

Paragraph 91. Indirect costs are costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include depreciation of capitalized equipment and utilities.

Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property Plant and Equipment*

Paragraph 26. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use.

Paragraph 29. The cost of general PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.)

Statement of Position entitled "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants

Paragraph 28. Costs incurred during the acquisition-or-construction stage should be charged to expense as incurred unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include certain costs directly related to activities performed by the entity (or parties not independent of the entity) for the acquisition, construction, or installation of specific PP&E. These costs include only payroll and payroll-related costs of employees who devote time to a PP&E acquisition-or-construction stage activity, to the extent of time the employees spent directly on that activity and in proportion to the total hours employed.

Paragraph 28A. Occupancy costs, including rent and depreciation of facilities and other costs associated with facilities are excluded from directly identifiable costs and should be charged to expense as incurred.